



MEMORANDUM

July 7, 2004

TO: BOARD OF DIRECTORS

FROM: CHRIS TREESE

RE: CAPITAL REVENUES ALTERNATIVES

At the Ridgway Strategic Planning retreat, the Board indicated its partiality for additional water storage. Associated with this priority, the Board recognized the need “to establish funding mechanisms to pursue capital solutions.” This memo is intended to initiate discussion on revenue enhancement alternatives. The alternatives presented below are purely my brainstorms (or gentle mist, as the case may be).

OVERVIEW:

There are two broad strategies for capital resources enhancement: expense reductions and new or increased revenues. Various options for both alternatives are outlined below. All the alternatives have pluses and minuses. However, none is presented or explored in detail. Neither are any presented as a recommendation, simply as a departure point for discussion. Before pursuing any of these options, the Board must first consider the policy implications of subsidizing water development with public funds and the relative lack of demonstrated purpose and need for significant water storage in most the District.

COST REDUCTIONS:

1. Staff Reductions:

There are relatively few alternatives for meaningful cost reductions. Salaries and overhead constitute over 40% of the River District’s general fund expenses. To make consequential reductions in the budget, the Board would have to consider staff layoffs. To offer up my own department for illustration, eliminating all governmental, educational and informational services and related programs, including laying off Peter Roessmann and me, would save over \$400,000 annually. Roughly a third of this savings would be from the enterprise fund.

It would be difficult to justify laying off any of the technical, legal or support staff if the District places a new emphasis on capital construction. In fact, additional hires may be necessary depending on the Board's approach and prioritization to new construction.

Considerations:

Reducing staff is contrary to several of the Board's other goals and programs identified at the retreat (e.g., additional staff to assist negotiations; develop external relationships/partnerships; targeted legislative/regulatory strategies).

2. Eliminate/Change Grants Program:

For the past six years, the board has budgeted roughly \$150,000 annually to fund a district-wide grants program to assist various kinds of water projects and related planning efforts. This annual appropriation "skims" the interest off the Capital Fund. As such, it reduces the Fund's ability to keep pace with inflation. While this is a small source of funds annually, our grants to date total nearly \$1 million. In other words, it adds up.

As an alternative to eliminating the Grants program, the Board may want to consider shifting the emphasis of the present Grants program from small, assistance grants to larger grants for water storage construction projects only. While this wouldn't advance River District ownership of newly developed water storage, it may spur additional in-District water storage projects.

Considerations:

The Board's Grants program has been increasing in popularity annually as evidenced by the number of applications received. One philosophy behind the Grants program was a recognition that the River District is not always the logical sponsor for certain water projects. Additionally, the grants program has been an excellent way to find out what others are accomplishing in terms of water development and use in the District.

3. Other Budget Reductions:

Other potential budget areas for reductions may include eliminating the Outside Legal budget or the gaging program. We budget approximately \$400,000 per year for outside legal counsel and \$250,000 for assistance to the USGS gaging program.

Considerations:

Obviously, eliminating all outside legal counsel will place an additional burden on existing staff and may leave the Board without legal expertise in some areas of business law. Eliminating both of these budget areas may, in fact, be contrary or at least detrimental to the overall goal of developing additional water storage as these budget items are generally supportive of any future emphasis on water development.

REVENUE ENHANCEMENTS

1. Maximize Enterprise Revenues:

The Board may wish to review its water marketing policy with an eye towards maximizing revenues by increasing prices wherever possible. The Board's basic philosophy in price setting for existing water supplies historically has been cost recovery based on the District's cost of that water (O & M and cost recovery).

One alternative would be to consider water pricing based on market values or replacement costs. The Board considered the market influence of the Bureau's pricing of Green Mountain Reservoir water when price setting occurred for Wolford Mountain water. However, in the aftermath of the drought of 2002, the Bureau is no longer letting new Green Mountain contracts. Additionally, with the benefit of 2002 as hindsight, Green Mountain contracts, if available, are not as attractive as they once were.

For separate reasons the contract price of Ruedi water is escalating rapidly. With Ruedi's pricing formula, Ruedi water sales will soon be prohibitively expensive and no longer a competitive alternative to the River District's water supplies. Accordingly, there may be an opportunity to increase Enterprise Water prices to better reflect market conditions.

Considerations:

The board has a policy based on serving its constituents with the lowest cost water justifiable while remaining true to an Enterprise philosophy. Market or replacement cost pricing would be a significant change in that philosophy and could also conflict with the board's desire to provide water for agriculture on a separate, subsidized pricing structure. The Board should also consider the possibility that demand for water is in fact elastic and that increasing water prices may result in a decrease in total revenues. (See also Dave Merritt's memo on Eagle River water pricing under Enterprise Tab #3d.)

2. Federal Legislation:

Federal funding for water projects has slowed to a trickle, but it hasn't evaporated completely. Elkhead is certainly a prime example of significant federal assistance to a water storage project. Authorization for expansion of Pueblo and Turquoise Reservoirs is central to Southeastern's proposed PSOP legislation. Taking a page from Chairman Aspinall's strategy book, support for a federal project on the West Slope could be a prerequisite for our support for PSOP legislation or the required future legislation for expansion of Pueblo or Turquoise.

The River District has been getting incrementally more involved in federal legislation, especially appropriations bills. The past two years, we assisted in securing \$750,000 for the Uncompahgre and Grand Valleys to address selenium concerns. Just recently, Senator Allard successfully amended the Water Resources Development Act (WRDA) to include \$5 million for selenium studies and

demonstration projects in Colorado.

There are a variety of water bills that arise annually. (See my Federal Affairs memo under Tab #10b.) Any of these bills can be a vehicle for federal assistance with a mature water storage project, especially if it meets some politically correct purpose such as water quality improvements or endangered species habitat enhancements. Moreover, newly emerging Western Water issues, from Compact administration to interstate water quality concerns, are likely to come before Congress in the upcoming years. Any of these can be considered opportunities to seek additional water storage as a component to any legislative solution. Additionally, federal authorizing and appropriations legislation will be required with several of the other alternatives presented below (e.g., federal partnerships).

Considerations:

As the Board knows well, successful pursuit of federal legislation to fully, or even significantly, fund water resource projects is a long, expensive and highly uncertain strategy with considerable front end expense. A new emphasis on federal assistance would require substantial additional budget resources dedicated to D.C. representation.

3. State Legislation:

The River District supported Representative Weins' sales tax bill this year until it was amended into something else and subsequently defeated. Voter approval for any new tax would still be required under TABOR, but a new funding mechanism (e.g., sales tax) may be more palatable to voters of the District or sub-district.

Other state legislation that the Board may wish to consider includes changing Colorado's severance tax distribution formula to more resemble Wyoming's model which allows for direct involvement and financial support of water storage projects. Additionally, the Board may want to explore changing the onerous signature requirements to create a sub-District, currently 50% of all landowners within the proposed district.

Considerations:

Each of these proposals has its opponents. The business community along with counties and municipalities will oppose more layers of sales tax authorities. Everyone currently receiving severance tax revenues will be threatened by just the discussion of changing the severance tax distribution formula. Increasing severance tax naturally will be opposed by any industry upon which we propose the increase. Property rights and anti-tax groups will resist any relaxation of current requirements to form sub-districts as a first step to raising taxes. I don't anticipate many allies within the water community for these approaches.

4. Pursue Grants:

There are a variety of sources of grant funding available to support River District activities that may in turn be used to offset general fund revenues. The 2002 Congressional Farm bill alone has

numerous opportunities for grant funding or assistance. Similarly, EPA and other sources have funds for watershed planning and water quality improvement programs. Other non-federal sources of grant funds also exist. Outside sources of income could be used to offset General Fund resources which could in turn be allocated to the Capital Fund for project construction.

Considerations:

Applying for grants can be a full time, professional responsibility. Associated with any grant, the District will have reporting requirements (i.e., staff overhead) and the possibility that we have to “shade” our mission to meet the purposes of the grant(s). Moreover, chasing grants has led other organizations to set their annual goals and priorities according to the grants in hand or presumed available to the detriment of other, more pressing needs or core values of the organization.

5. Voter-Approved Revenue Enhancement:

There are several alternatives under the general strategy of seeking voter approval for additional River District revenues. Three are outlined below.

- **de-Bruicing:** The Board is familiar with this alternative having asked for voter approval to de-Bruice twice in the past two years. One variation from the approach we have taken to date would be to commit in the language of our ballot question to dedicate any additional revenues accruing to the District as a result of de-Bruicing to capital projects or to specify those projects.
- **Mill Levy Increase:** A more direct option and one with greater direct benefit sooner would be for the Board to request a specific mill levy increase which it can commit to capital construction or specific projects. Again, lessons learned from Referenda A and 4A alike, argue for project identification.
- **Sub-Districts:** To construct the Taylor Draw project near Rangely, the District created sub-district. The Board is authorized to create sub-districts to construct projects. Voter approval would still be required for any new funding mechanism, but the increase would apply to a limited geography, presumably that area directly benefitting from the proposed project. This direct and identified benefit, along with our ability to target specific areas and projects could increase the probability of success of sub-district ballot questions.

Considerations:

There are numerous drawbacks to the above alternatives, some are applicable to all, some are unique to the specific alternative. The Board may desire a separate memo on the advantages and disadvantages of ballot question variations. The Board should also carefully consider the specter that a third rejection by voters may cast on the District before we return to the ballot prematurely.

6. Creative Partnerships:

To me, the most significant aspect of the planned Elkhead enlargement is the participation of the US Fish & Wildlife Service. In dramatic contrast to the recent train wreck in the Klamath Falls basin, at Elkhead the federal government is directly participating in new water storage to met the water

needs of endangered species. Future partnerships with federal agencies to upgrade native species habitats (USFS/BLM) or improve water quality (EPA) could be explored.

The River District constructed Wolford Mountain Reservoir as a result of another unique “partnership” with Northern’s municipal subdistrict and Denver Water. Similar east-west partnerships could be another way to address some of the difficult obstacles to water project funding.

Considerations:

Partnerships, like grants, may mean relinquishing some District autonomy regarding priorities, direction, purpose and goals of water development. Additionally, there may be political fallout depending on with whom and under what conditions the District partners. Furthermore, Elkhead has taught us that additional partners increases institutional hurdles further complicating the project development process.

7. Calendar Sales

With the popularity of recent movies like the Full Monty and Calendar Girls, there has been an explosion of posters, calendars, and other merchandise revealing a variety of organizations’ board members in their most natural state with the barest of strategically placed props to preserve a minimum level of decency. Sales of these products and images could be dedicated to future water project development.

Considerations:

The Board may wish to consider the marketability of a River District Board calendar in the all-in-all and the difficult task of choosing your most marketable twelve. Staff will not engage in either of these discussions.

CONCLUSIONS:

Staff has no specific recommendation regarding funding alternatives. This memo is intended purely to spark discussion and stimulate debate regarding options and their companion challenges related to potential capital project revenue sources. We anticipate that the Board will provide additional direction concerning acceptable alternatives and request additional staff analysis.